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APPLICATION OF

VIRGINIA NATURAL GAS, INC.

CASE NO. PUE970617

For an annual informational filing

REPORT OF DEBORAH V. ELLENBERG, CHIEF HEARING EXAMINER

July 13, 2000

This case originally was docketed to address the Annual Informational Filing ("AIF") of Virginia Natural Gas, Inc. ("VNG" or the "Company") for the test period ending June 30, 1997. On June 12, 1998, VNG filed a motion for leave to file an abbreviated AIF for those 12 months ending June 30, 1997 because it also had to prepare an AIF for the 12-month period ending June 30, 1998. By Order dated June 26, 1998, the Commission granted the motion in part allowing for an abbreviated AIF for the test period ending June 30, 1997, and directing that all schedules required for AIFs by the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings be filed for the test period ending June 30, 1998.

On July 27, 1998, VNG submitted the abbreviated filing with an earnings test for the test period ending June 30, 1997. That test yielded an adjusted rate of return on equity of 7.77%. VNG submitted several revised pages in response to discussions with Staff, and on October 27, 1998, Staff filed its report. It found that several different measures yielded a return on equity between 7.77% and 8.66%, all well below the authorized range of 10.40% to 11.40%. Staff therefore recommended no further action on the AIF for the twelve-month period ending June 30, 1997.

While that filing was being considered, VNG also sought an extension of time to file its AIF for the 12-month period ending June 30, 1998. The Commission granted an extension and directed that the filing be made on or before November 25, 1998. VNG submitted that filing as directed on November 25, 1998. That AIF was based on financial and operating data for the twelve months ending June 30, 1998. The Company included in its filing a weather-normalized earnings test and an earnings test based on actual weather.

Staff filed a report on April 15, 1999. Staff concluded that based on a weather-normalized earnings test, test year jurisdictional earnings, average rate base, average capital structure, and limited adjustments, VNG earned a return on equity of 11.09%. Its authorized return on equity range was 10.40% - 11.40%. Staff advised that the implementation cost of accrual accounting for postretirement benefits other than pensions ("OPEB") was the only regulatory asset remaining on VNG's books and should be written off. The Virginia jurisdictional portion of the asset is \$1,381,920. Such a write-off would reduce VNG's return on equity to 10.55%.

VNG disagreed, and on May 13, 1999, requested a hearing. It asserted that the earnings test analysis conducted by Staff was flawed. On May 21, 1999, the Commission entered an order establishing a procedural schedule and set the matter for hearing.

A hearing was convened on July 28, 1999. Guy T. Tripp, III, Esquire and Donald A. Fickenschier, Esquire, appeared as counsel for VNG. Sherry Bridewell, Esquire, appeared as counsel for the Commission's Staff. Testimony was offered by Company witnesses Robert D. Phillips and Jeffrey L. Huston, and by Staff witnesses Janel F. English and John R. Ballsrud. A transcript of that hearing is filed with this Report.

Post-hearing memoranda were filed by Staff and the Company on October 6, 1999.

SUMMARY OF THE RECORD

The Company filed the testimony of Robert D. Phillips, senior rate analyst.¹ Mr. Phillips argues that the earnings test should not have been weather normalized.² He testified that a properly formulated earnings test based on actual weather, after applying only adjustments necessary to restate test period results on a regulatory basis, shows that VNG's actual return on equity for the test period was 9.18%, below the bottom of its authorized range.³ He also testified that Staff's analysis failed to recognize underrecoveries of the OPEB implementation deferral from prior periods.⁴ He argued that an equitable solution would be to examine the entire recovery period to determine if the costs have been recovered more quickly than anticipated.⁵

Mr. Huston, director of base rate case management – Virginia, also offered testimony.⁶ He argued that actual results should always be used since an earnings test is meant to gauge the extent to which a utility has recovered the outstanding balance of a regulatory asset based on its operating performance.⁷ He observed that under Staff's analysis, a utility could have a strong financial performance resulting in higher than normal revenues due to colder than normal weather, yet avoid writing off any OPEB expenses booked as a regulatory asset.⁸

He argues that weather normalization is neither required nor appropriate to restate actual per books financial data to a regulatory basis. To the contrary, he asserts that weather normalization is properly within a class of accounting adjustments that restate current revenues, expenses and rate base to forward-looking levels,⁹ and is most commonly used to establish prospective rates.¹⁰ He testified that weather adjustment clauses also have been incorporated into the tariffs of some gas local distribution companies as mechanisms for stabilizing the utilities' revenues and income.¹¹ He

¹Exhibit RDP-1.

²Id. at 2.

³Id.

⁴Id.

⁵Id.

⁶Exhibit JLH-5.

⁷Id. at 3.

⁸Id.

⁹Id.

¹⁰Id. at 4.

¹¹Id.

argues that if the Commission decides that revenue should be imputed for the test period to determine OPEB cost recovery, a mismatch will result that can only be eliminated by permitting VNG to retroactively implement a weather adjustment clause.¹²

Mr. Huston further testified that the recovery period scheduled for VNG's OPEB deferral was 40 years beginning in 1994, yet Staff's recommendation is based only on the 12-month period ending June 30, 1998.¹³ Mr. Huston also suggested that the period of examination for an earnings test to determine if OPEB deferrals have been recovered earlier than expected should be expanded to include all available earnings data since the creation of the regulatory asset.¹⁴

Staff witness Janel English, public utility accountant for the Division of Public Utility Accounting, acknowledged that the Commission has applied an earnings test using actual weather in a number of cases to determine if regulatory assets have been recovered earlier than anticipated.¹⁵ She, however, asserts that in all of those cases, the regulatory asset at issue was short-lived or established after application of an earnings test based on actual weather.¹⁶ She argues that the deferral of OPEB implementation costs for VNG is quite different. It is not short-lived, but rather was created with an expected life of 40 years, and it was established after a weather-normalized earnings test was conducted to determine that VNG did not have adequate earnings to have recovered the implementation costs at the time they were incurred.¹⁷ Ms. English maintains that it is proper to gauge earnings based on actual weather for short-lived assets because normal weather will not occur over the short term but that per books results should be weather normalized when measuring earnings for the purpose of determining the recovery of a regulatory asset with a long life, such as OPEB implementation costs.¹⁸ Ms. English reported that VNG had argued in support of weather normalizing the earnings test applied to OPEB costs when the Commission established the ratemaking treatment for OPEB related costs in 1992.¹⁹

John R. Ballsrud, with the Division of Economics and Finance, also sponsored financial analyses for VNG.²⁰ His testimony supports, in part, writing regulatory assets to the bottom of a utility's authorized return on equity range.²¹ Although the accounting adjustment to weather normalize the earnings data supported by Ms. English is at issue, the analyses that Mr. Ballsrud conducted are not otherwise in dispute.

In rebuttal testimony Mr. Phillips again argued that \$4.9 million should not be added to VNG's actual test period revenue.²² He reiterated that VNG did not have actual test period earnings in excess of the bottom of its authorized range.²³

¹²Id. at 4-5.

¹³Id. at 5.

¹⁴Id.

¹⁵Exhibit JFE-7, at 6-7.

¹⁶Id.

¹⁷Transcript 52, 58.

¹⁸Id.; Exhibit JFE-7, at 7.

¹⁹Exhibit JFE-7, at 5, and Exhibit JFE-7, Ex. 4.

²⁰Exhibit JRB-6.

²¹Exhibit JRB-6, at 2-4.

²²Exhibit RDP-2, at 1.

²³Id.

Mr. Phillips acknowledged that VNG comments filed in 1992 when the Commission established rules governing accounting for OPEB urged that the determination of “. . . whether a utility is earning below its authorized return on equity range should be made on a weather normalized basis because rates are set on that basis.”²⁴ He argued that VNG’s comments were consistent with its position in this case because in those comments, VNG was simply recognizing that rates for gas distribution companies are set on the basis of normalized weather due to the significant impact of weather on gas sales from year to year.²⁵ He contends that VNG did not argue each year’s operating results should be examined on a normalized rather than actual weather basis to determine whether a regulatory asset was actually being recovered more rapidly than originally scheduled.²⁶

Mr. Phillips explained that the regulatory asset at issue was established after reviewing earnings data for a 21-month period from January 1, 1993 to September 30, 1994, during which time VNG’s return based on actual weather was 6.37%.²⁷ He admitted that a weather normalization adjustment was made to increase revenues by \$1,737,683. That adjustment increased the computed return to 7.21%.²⁸ Both analyses, however, resulted in rates of return substantially below the bottom of VNG’s authorized return on equity range which averaged between 11.25% and 12.25% during that period.²⁹ Therefore weather normalizing the earnings test data had no effect on the Commission’s decision to allow VNG to defer the OPEB transition costs as a regulatory asset. The asset would have been established even if revenues had not been adjusted for normal weather. The adjustment, in fact, increased revenues for the earnings test. Finally, Mr. Phillips also observed that Staff’s position results in different treatment of OPEB regulatory assets for gas and electric companies because electric revenues are not normalized.³⁰

DISCUSSION

Several issues rise out of the dispute between Staff and the Company: 1) whether the OPEB implementation deferral should be distinguished from other regulatory assets and evaluated on a normal weather basis; 2) whether VNG’s prior period earnings should be considered in evaluating whether the OPEB implementation deferral has been recovered; and 3) whether VNG must fund the OPEB recovery or deduct the associated unfunded liability from its ratebase if the OPEB deferral is written off.

OPEB ratemaking treatment

In December 1990, the Financial Accounting Standards Board issued Statement 106 changing the generally accepted accounting for expenses related to postretirement employment benefits other than pensions or OPEB. Companies were directed to begin accruing such expenses as they were earned by employees rather than recognize the benefit costs at the time they were paid

²⁴Id. at 2.

²⁵Id.

²⁶Id.

²⁷Id.

²⁸Id.

²⁹Id.

³⁰Id.

out. This change was effective for fiscal years beginning after December 15, 1992, for publicly held companies.

On December 30, 1992, the Commission prescribed ratemaking treatment for affected Virginia utilities.³¹ Therein the Commission provided for an amortization period of 40 years on the transition obligation arising from implementation of the change, required funding of OPEB expenses before they could be included in rates, and provided that the timing difference in the implementation of accrual accounting for the expenses for reporting and ratemaking purposes could be deferred if certain conditions were met.³² Utilities that did not adjust their rates coincident with implementation of the Statement 106 accrual were allowed to defer the timing difference as a regulatory asset³³ if the company was earning below its authorized rate of return on equity and filed for a change in rates within two years of implementing Statement 106 or by December 30, 1994, whichever was later.³⁴ Any timing differences were to be added to the transition obligation and also amortized over 40 years.³⁵ In its final order defining that ratemaking treatment, the Commission provided that:

[U]tilities which will not adjust rates coincident with implementation of the SFAS 106 accrual may defer the difference between accrual of OPEB expenses for reporting and ratemaking purposes as a regulatory asset upon two conditions. Such deferral will only be available if the company is earning below its authorized range of return on equity and will file for a change in rates within two years of implementing SFAS 106 or two years of this order, whichever is later. The earnings test period should coincide with the period the accrual is being booked.³⁶

VNG met those criteria and in its 1994 rate case³⁷ was authorized to create a regulatory asset for the OPEB implementation costs in the amount of \$1,629,184 to be amortized over 40 years.³⁸ In the pending AIF, Staff conducted an earnings test to review VNG's earnings during the test period, determined VNG earned above the bottom of its authorized range for the 12 months ending June 30, 1998, and recommends that VNG write off the balance of the deferred OPEB implementation costs.

Earnings Test

³¹*Commonwealth of Virginia, ex rel. State Corporation Commission Ex Parte, In re: Consideration of a rule governing Accounting for Postretirement Benefits other than Pensions ("OPEB Rulemaking")*, Final Order Case No. PUE920003, 1992 S.C.C. Ann. Rep. 315.

³²*Id.* at 316.

³³A regulatory asset is a deferral of a current period cost which is amortized over an extended period of time for ratemaking. Such costs are generally large and nonrecurring, but may materially and negatively impact a utility's financial results. The deferral allows a regulated company to recover extraordinary expenses from ratepayers over extended periods, and is an effective sharing mechanism providing rate stability and protection for the ratepayer and an opportunity to recover extraordinary but reasonable costs for the company. Booking regulatory assets thus allows a company to recover costs such as the OPEB transition costs, but is not a guarantee of recovery.

³⁴*OPEB Rulemaking, supra*, 1992 S.C.C. Ann. Rep. at 316.

³⁵*Id.*

³⁶*Id.*

³⁷Exhibits JFE-7, at 4 and RDB-2, at 3.

³⁸Exhibit RDB-2, at 3.

An earnings test is a per books measurement of historic earnings based on average rate base and investment. Adjustments are made to restate the per books data to a regulatory basis, but the purpose of the test is to review historic earnings, not to set future rates. On several occasions the Commission has considered and applied earnings tests to judge whether a regulatory asset should be established.³⁹ There is also clearly established precedent to support the application of an earnings test to determine if an established regulatory asset has been recovered more quickly than expected. In 1998, the Commission decided a series of particularly relevant cases.⁴⁰

In the *Roanoke* case, the Commission addressed the application of an earnings test to new and established regulatory assets including rate case expenses, costs of a depreciation study, franchise costs, negotiation costs, union organization costs, early retirement costs associated with personnel, and demolition costs related to a retired manufacturing gas plant. All of those regulatory assets had short amortization lives from three to five years.

In that case *Roanoke* argued that application of an earnings test to regulatory assets constituted retroactive ratemaking, and further argued that if an earnings test was to be applied, it should be fully adjusted to include the effects of weather normalization, and the write-off of regulatory assets should be made only with earnings exceeding the top of its return on equity range. Staff argued the earnings test was appropriate, should not be weather normalized and urged the Commission to write off regulatory assets to the bottom of the authorized range. The Commission held that “[a]n earnings test is applied to earnings results within a test period. . . the purpose of an earnings test is to evaluate whether regulatory assets on the utility’s books during the test period have been recovered more quickly than anticipated or whether they should continue to be deferred and amortized.”⁴¹ The Commission concluded that application of an earnings test to test period revenues did not constitute retroactive ratemaking, should not be weather normalized, and regulatory assets could be written off as long as the company was earning at or above the bottom of its authorized range. The Commission held that:

[T]he per books results of the earnings test should not be weather normalized. Instead, an earnings test employs per books data for a test period, based on average rate base and investment. Typical adjustments used in an earnings test are those necessary to restate per books results to a regulatory basis, such as adjustments to correct booking errors and inclusion of JDC capital expense and associated tax savings.⁴²

³⁹*Ex Parte: In the matter of establishing Commission policy regarding rate treatment of purchased power capacity charges by electric utilities and cooperatives*, Case No. PUE880052, 1998 S.C.C. Ann. Rep. 346; *Application of Virginia Electric and Power Company*, Case No. PUE880014, 1988 S.C.C. Ann. Rep. 312, 314; *Appalachian Power Company*, Case No. PUE940063, 1996 S.C.C. Ann. Rep. 255.

⁴⁰*Application of Roanoke Gas Company, For an Annual Informational Filing and Application of Roanoke Gas Company, For expedited rate relief*, Case Nos. PUE960102 and PUE960304, 1998 S.C.C. Ann. Rep. 327 (the “*Roanoke case*”); *Application of Washington Gas Light Company, Virginia Division, For an Annual Informational Filing (“WGL”)*, Case No. PUE970328, 1998 S.C.C. Ann. Rep. 360; *Application of Columbia Gas of Virginia, Inc., For a general increase in natural gas rates and approval of performance-based rate regulation methodology pursuant to Section 56-235.6 of the Code of Virginia*, Case No. PUE970455, Final Order dated February 19, 1999.

⁴¹*Roanoke*, supra, 1998 S.C.C. Ann. Rep. at 329.

⁴²Id.

The Commission also observed that:

The earnings test simply measures, period to period, whether deferred expenses have been actually recovered more quickly than originally anticipated or whether they should continue to be deferred and amortized. The test is the same used to establish the original amount of the deferral and is fair to both shareholders and ratepayers.⁴³

In another case, *Application of Washington Gas Light Company, Virginia Division, For an Annual Informational Filing*, Case No. PUE970328, 1998 S.C.C. Ann. Rep. 360, the Commission considered losses on reacquired debt. A loss on reacquired debt is an accounting classification for several types of expenses associated with the retirement or reacquisition of debt securities prior to their maturity. Some of the assets at issue in this case had long lives.

In the final order in that case, however, the Commission concluded that losses on reacquired debt refunded with long-term debt, although booked as a regulatory asset, should not be subject to an earnings test.⁴⁴ The Commission concluded that losses on reacquired debt with refunding have been amortized over the life of the refunding debt for a finite identifiable period; were explicitly tied to a refinancing where the losses are intentionally incurred in order to produce savings in the form of lower interest rates; and therefore, the costs of issuing the new debt were more like other types of debt issuance expenses and should not be subject to an earnings test. The Commission included OPEB implementation costs in a list of regulatory assets to which an earnings test should be applied, but made no distinction between OPEB regulatory assets and other regulatory assets.⁴⁵

Finally, in a case involving Columbia Gas of Virginia, Inc., the regulatory assets at issue related to restructuring costs and the costs of environmental clean-up. Those assets had amortization periods much shorter than 40 years and were established after an earnings test using actual weather was applied. Therefore the earnings test conducted in that case to judge the recovery of assets during the test period, also reflected actual weather.⁴⁶

The OPEB deferral is different from most regulatory assets

With only one exception,⁴⁷ the OPEB implementation costs were established as assets on the books of Virginia natural gas utilities after subjecting the costs to a weather-normalized earnings test.⁴⁸ Those gas companies routinely normalize revenues for ratemaking purposes. The other

⁴³*Id.* at 330.

⁴⁴The Commission also found that losses on reacquired debt without refunding may be different in character than losses on reacquired debt with refunding and that the question of whether those losses should be subject to an earnings test should be examined in future cases.

⁴⁵*WGL, supra*, 1998 S.C.C. Ann. Rep. 360.

⁴⁶*Application of Columbia Gas of Virginia, Inc., For a general increase in natural gas rates and approval of performance-based rate regulation methodology pursuant to Section 56-235.6 of the Code of Virginia*, Case No. PUE970455, Final Order dated February 19, 1999.

⁴⁷Shenandoah Gas Company used an earnings test reflecting actual weather because it did not calculate its cost of service using a weather normalization adjustment.

⁴⁸Transcript 55; Staff Brief at 4.

regulatory assets that have been reviewed by the Commission in the cases cited above were established without applying an earnings test, or more recently, after application of an earnings test using actual weather. Only OPEB implementation costs for gas companies were deferred as a regulatory asset after application of a weather-normalized test. Staff asserts that recovery of the asset should be consistently judged in the same manner the asset was established. Thus, Staff argues that since the OPEB implementation costs were evaluated after earnings test data were normalized, recovery should be similarly judged. The Company argues that although the earnings test data were normalized when the OPEB regulatory asset was created, an earnings test reflecting actual weather would also have resulted in allowance of the deferral. Thus the end result was not affected by the weather adjustment.

The other significant difference between the OPEB regulatory asset and most regulatory assets is the expected life of the assets. The recovery period for the OPEB implementation costs is 40 years. Unquestionably these assets have longer lives than the regulatory assets addressed in the *Roanoke* and *Columbia* cases. The significance of the life of the asset was discussed in the *Washington Gas* case⁴⁹, but was not decided. Some of those assets were to be amortized over 30 years. Almost 96% of the total amount in question had amortization periods of at least 10 years.⁵⁰ In that case WGL argued that the test period results should be weather normalized. Staff again argued actual weather should be used. The hearing examiner agreed that actual weather should be used, and concluded that "[t]he purpose of an earnings test, however, is to judge actual earnings during the test period; therefore, with the exception of OPEB, which for gas companies was subject to a weather-normalized earnings test at its inception, actual earnings should serve as the focus."⁵¹

That passage was cited in this case to support the proposition that an earnings test to measure the recovery of OPEB regulatory assets should be weather normalized. It was intended, however, only to reserve review of that question on the basis of a record focused on OPEB and the substantial difference between OPEB and other costs afforded treatment as regulatory assets.

Since the Commission ultimately did not subject those long-lived assets in the *WGL* case to an earnings test, it did not address the relevance of the life of the asset to the decision to use actual weather in the earnings test. Staff considers the life of an asset to be very significant, and argues that normal weather will not occur over a short life, but will occur over a longer period. VNG maintains that the life of the asset should not influence the weather adjustment, and actual earnings should be reviewed regardless of the life.

⁴⁹ *WGL*, supra, 1998 S.C.C. Ann. Rep. 360.

⁵⁰ *WGL*, supra, Case No. PUE970328, Hearing Examiner Report at 8 (June 25, 1998).

⁵¹ *Id.* at 9.

The earnings test in this case should not be weather normalized

Ronald A. Gibson, director of the Commission's Division of Accounting had also instructed Virginia utilities that to "reflect normal weather would not be appropriate for the earnings test" in a letter dated March 29, 1995.⁵² Therein, Mr. Gibson advised all utilities that the earnings test would be based on per books, Virginia jurisdictional results, and further:

Limited adjustments should be made in order to restate books to a ratemaking basis and to determine earnings relative to average investment. Adjustments to reflect normal weather would not be appropriate for the earnings test. Furthermore, in the context of AIF's or rate filings in future years, unamortized balances of regulatory assets will be subject to full or partial write-off in the event an overearnings situation develops.

In its instructions, the letter makes no distinction between earnings tests to measure recovery of OPEB regulatory assets and other regulatory assets. However, as Staff observed, the OPEB implementation costs were deferred as regulatory assets before this letter was written and some were created subject to a weather normalization test.

In the *Columbia* case Staff argued that it did not adjust for normal weather in earnings tests because only actual weather allows proper measurement of test year earnings; a weather normalization adjustment in an earnings test would mask actual results; normal weather is appropriate for setting future rates but inappropriate for determining whether costs associated with regulatory assets have actually been recovered in the past; and weather is a natural business risk of any utility and it should not be shielded from that risk when performing an earnings test.⁵³ Those reasons are no less applicable to an OPEB regulatory asset, no matter how different it might be from the majority of regulatory assets.

Moreover, the Commission has clearly stated that "the purpose of an earnings test is to review test period results to determine whether deferred costs were **actually** recovered more quickly than anticipated. Accordingly, the per books results of the earnings test should not be weather normalized (emphasis added)."⁵⁴

Staff urges the Commission to treat some OPEB implementation costs differently from other regulatory assets, and an initial analysis might lead to a conclusion that consistency requires use of a weather-normalized test since some assets were established based on such a test. As already discussed, the OPEB regulatory assets here were established based on a weather-normalized test, but an earnings test conducted using actual weather would have yielded the same result because, by either measure, VNG's equity return was below the bottom of its authorized return at the time it was authorized to create the regulatory asset. VNG's return on equity using actual weather was 6.372%.⁵⁵ Based on normalized weather, its return on equity was 7.207%.⁵⁶ Both earnings test

⁵²Exhibit RDP-4.

⁵³Exhibit RDP-1, at 3-4.

⁵⁴*Roanoke, supra*, 1998 S.C.C. Ann. Rep. 329.

⁵⁵Exhibit JFE-7, Exhibit 4, at 3.

⁵⁶*Id.*

returns were substantially less than VNG's authorized 11.75% return on equity. Thus regardless of which analysis was used, VNG would have been authorized to establish the regulatory asset in its 1994 rate case.

Moreover, it is true that the amortization period may be longer than most assets, but either recovery has occurred earlier than expected or it has not. In the *Washington Gas* case when we addressed regulatory assets with long lives, in some cases as long as 30 years, Staff and I urged the Commission to decline to distinguish between short- and long-lived assets. I found that:

While it is important to weather normalize revenues of a historic period when setting rates for the future because it is impossible to forecast weather for a future period with any certainty, there is no need to adjust for normal weather when your purpose is to review already known earnings during the test period. In addition, such an adjustment is inappropriate for most regulatory assets because “normal” weather does not occur over the short term. Weather normalizing known revenues and cost data will distort the Company’s actual earnings for the test period. Moreover, as a practical matter weather normalizing for some regulatory assets but not for others would further complicate the test, and potentially generate arguments over the distinction between short- and long-lived assets.⁵⁷

Further, as observed in the *WGL* case, a distinction between assets based on expected life will certainly engender arguments over what constitutes a long life. If we determine 40 years is a long life, and thus warrants different treatment, what about 30, or 20, or 10 years?

There are also several practical effects of Staff’s recommendation that support the consistent use of actual weather. VNG argues that if Staff’s position is adopted, it will never recover \$1,381,920 of OPEB expenses incurred during the 21-month period January 1, 1993 through September 30, 1994. Its actual earnings were inadequate to recover those expenses during the test period and have been below the bottom of the range for all periods relevant to this case since the inception of OPEB accruals on January 1, 1993.⁵⁸

VNG also observed that the treatment recommended by Staff could result in cases where gas utilities could overearn dramatically in a cold year but avoid writing off OPEB assets because weather normalization would reduce actual overearnings. Such a result would be contrary to the purpose of the test which is to determine if the utility has actually recovered regulatory assets earlier than anticipated when they were created.⁵⁹

⁵⁷ *WGL*, supra, Case No. PUE970328, Hearing Examiner's Report at 9 (June 25, 1998).

⁵⁸ VNG Brief at 8.

⁵⁹ Exhibit JLH-5, at 3.

Finally, VNG argues that if the Staff's position prevails, it would be necessary for utilities that have OPEB regulatory assets and one or more other regulatory assets on their books to conduct multiple earnings tests, one using actual weather and another test for the OPEB regulatory assets which would be weather normalized.⁶⁰

The earnings test at issue here is still intended to determine whether a regulatory asset has been recovered sooner than anticipated when the asset was established. The Commission should consistently use actual weather in earnings tests applicable to regulatory assets, including VNG's OPEB regulatory assets. The purpose of an earnings test is to judge actual earnings during the test period; hence the basis of the test should be actual earnings, not a calculation of the earnings the company would have generated if it had experienced normal weather during the test period. There is no need to adjust for weather when the purpose of the test is to review historic test period earnings. The question is simply whether recovery of the deferred expenses occurred earlier than expected, not whether it should have occurred earlier than expected if normal weather had occurred. Although OPEB implementation costs are clearly different from other regulatory assets, the earnings test conducted to determine whether this asset in this case has been recovered earlier than anticipated should be the same and based on actual weather.⁶¹

If actual weather is used, VNG asserts that actual earnings during the test period were not sufficient to recover more than the previously authorized annual amortization of the OPEB regulatory asset. VNG's test year return on equity was only 9.18%, which was below the bottom of its authorized return on equity range of 10.4 – 11.4%.⁶²

Prior period earnings should not be considered

Staff recommends that the recovery of this asset be evaluated on a 12-month test period basis. VNG argues that the entire period the OPEB costs have been booked as a regulatory asset should be used to judge its recovery. In the *Roanoke* case, the Commission addressed concerns with retroactive ratemaking raised by applying the earnings test to the test period, and concluded that application of an earnings test to judge recovery of regulatory assets during the test period did not constitute retroactive ratemaking.⁶³ Application to earlier periods however, does raise my concern with retroactively considering revenues from past periods. I agree with Staff that the earnings test should be applied only to judge recovery of regulatory assets during the test period in this case. Moreover, as a practical matter, judging recovery over the whole life of an asset would be burdensome as the regulatory assets on a company's books may have different lives.

⁶⁰VNG Brief at 10.

⁶¹In this case, VNG would have been permitted to establish a regulatory asset for OPEB on either a weather-normalized basis or using actual weather. The report issued herein addresses the issues and facts as they pertain to VNG. It does not address the factual circumstances of a utility that could have initially established OPEB as a regulatory asset only after considering weather-normalized earnings.

⁶²Exhibit RDP-1, at 5.

⁶³*Roanoke*, supra, 1998 S.C.C. Ann. Rep. at 329.

VNG must fund OPEB recovery or deduct unfunded liability from rate base.

The Commission established a funding requirement to ensure that adequate funds would be available for payment of benefits in the future.⁶⁴ The Commission clearly held that “unfunded OPEB liability shall be deducted from rate base unless deferred for regulatory purposes.”⁶⁵ Therefore, if the Commission concludes that the earnings test to judge recovery of OPEB deferred costs should be weather normalized and therefore the regulatory asset should be written off in this case, VNG must fund the amount written off or deduct it from rate base. The liability would no longer be deferred for regulatory purposes. The Commission’s direction in the OPEB order in this regard was clear.

FINDINGS AND RECOMMENDATIONS

Based on the evidence in the record in this proceeding, I find that:

1. The OPEB deferral is a regulatory asset subject to review using an earnings test;
2. The earnings test in this case should not be weather normalized;
3. VNG test period earnings produce a 9.18% return on equity which is below the bottom of its authorized range of 10.4% to 11.4%; and
4. The regulatory asset for OPEB implementation costs was not fully recovered during the test period.

Accordingly, ***I RECOMMEND*** the Commission enter an order:

- (1) ***ADOPTING*** the findings set forth above; and
- (2) ***DISMISSING*** this case from the Commission’s docket of active cases.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and Commission Rule 5:16(e)) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within twenty-one (21) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of

⁶⁴Exhibit JFE-7, at 10.

⁶⁵*OPEB Rulemaking*, supra, 1992 S.C.C. Ann. Rep. at 316.

such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

Deborah V. Ellenberg
Chief Hearing Examiner